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# Business in Brief

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**The business trend has turned up.** Production hit bottom in April, then rose in May and June. Recent trends in key economic sectors point to a further gain in business activity as the year progresses.

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**Business inventories** have been cut by about $3 billion since last fall. They're still above normal—by perhaps $2 billion. But the rate of inventory reduction is tapering. It ran to $6-7 billion yearly in early spring and may be down to $3 billion annually now. Thus a turnabout in inventory buying may come soon.

**Construction** remains one of the major areas of strength. With credit readily available, spending on housing is running ahead of a year earlier. And total construction is now expected to reach a record $36 billion this year, 2% ahead of 1953.

**Business capital investment** is still easing off. However, the rate of decline is slowing. This is a key factor to watch—for if business investment turns higher, that will be a sure sign of good economic health.

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**Defense spending** has dropped from $53.5 billion annually a year ago to $44.5 billion now. Current schedules call for a more gradual decline in the coming year —to a $40.5 billion rate by mid-1955. So the major economic impact of the defense cutback is behind us.

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**Second quarter retail sales** matched last year's level. Consumer purchasing power almost equals the 1953 peak. Wage rates are higher, tax liabilities are lower, and prices are down slightly. These factors, plus larger social security payments, have about offset the impact of unemployment and shorter hours on purchasing power. So consumer markets are strong.

**Auto sales** totaled 2.8 million in the first half. If the prewar seasonal pattern (55% of sales in the first six months) holds, that points to sales of about 5.1 million new cars this year.

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Now that the business downtrend has been checked, the job ahead is clear. It is to make sure that the current business upturn develops into a period of sustained, soundly-based economic growth.

**The Eisenhower Administration has achieved two notable objectives.** It stopped the Korean War, and it moved—vigorously and effectively—to ease the transition to a peacetime economy.

• Tax reductions fully match the cut in Federal spending. Thus $7.4 billion that was being spent by government is made available for private spending.

• The prompt and aggressive shift to a policy of "active ease" in the money markets has stimulated housing, public works and other building, helped hold up business investment and kept the inventory adjustment orderly.

• Critical areas are bolstered—Expenditures for farm price support are at a $3 billion annual rate and stockpile purchases may exceed $500 million.

**Not all of the Administration's economic program has yet been approved by Congress.** However, the program as a whole embodies a comprehensive and positive approach to the difficult problem of attaining a sound and expanding prosperity. Here are some of its features:

• The **Highway Act** will boost roadbuilding by an estimated $1 billion annual rate by year's end.

• The **Housing Act,** if enacted as submitted, could increase homebuilding by up to $2 billion a year.

• The proposed expansion of **social security** may add as much as $1 billion to purchasing power.

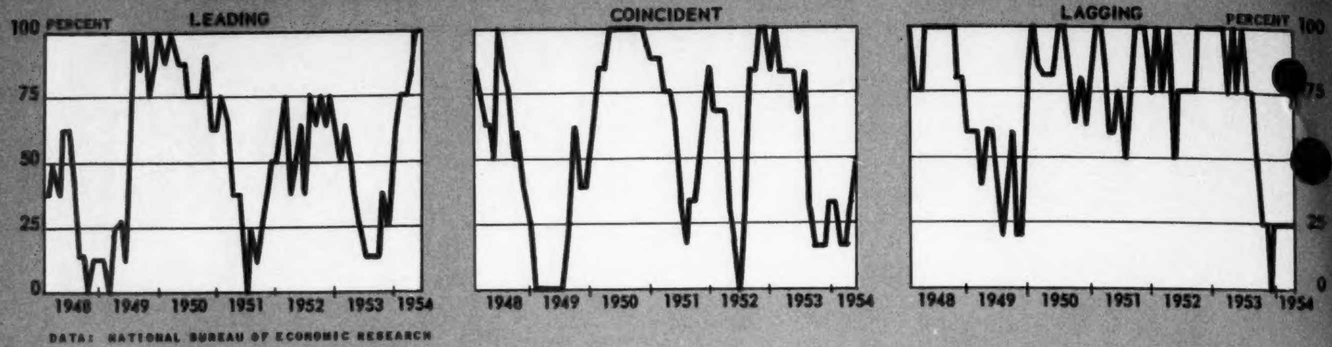
• The **farm program**—designed with real foresight and courage by the Secretary of Agriculture—proposes a gradual shift to flexible price supports to help adjust farm output to demand. In the long run, this will serve the best interests of both farmers and consumers.

• The proposed **tax revision program** should greatly stimulate business capital investment and expenditures for research and development.

• The Administration's **foreign economic program** would expand trade and foreign investment and encourage currency convertibility—thus reducing the need for foreign aid.

**Full enactment of the program could lay the foundation for a renewed period of growth and prosperity.**

INDICATORS SHOW SAME PICTURE AS IN MID-1949 WHEN BUSINESS TURNED UP




DATA: NATIONAL BUREAU OF ECONOMIC RESEARCH

# KEY BUSINESS INDICATORS

How can we tell whether the business curve has turned up again? One method is to look at the key business indicators selected by the National Bureau of Economic Research as the most reliable harbingers of economic change. (See BUSINESS IN BRIEF, November 1953.)

### Current Trends

The Bureau's studies of more than 800 economic series showed eight that consistently turned up or down in advance of general business. Latest statistics indicate that all eight are now pointing to an uptrend. So are three of the six coincident indicators—series that move up or down simultaneously with general business.

To sum up the picture shown by the indicators, the National Bureau worked out two procedures. One is to compute the percentage of the series that are expanding. If half of them show an uptrend, then the percentage expanding is 50%. In past business cycles, this method provided a clear signal of an upturn when:

- More than three-fourths of the leading indicators were expanding; and
- Half of the coincident series were moving up.

At present all the leading indicators point up, and half the coincident ones show an expanding trend. On this basis, the indicators point definitely to an upturn in business activity.

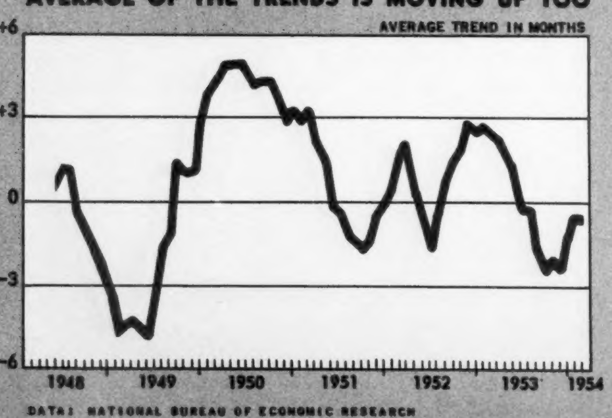
A second method of adding up the indicators is to examine the trends in the series to see how long the average of such trends has been expanding or declining. Experience shows that when the average trend turns around and moves in the same direction for three months or more, a significant change has occurred. Every time the average trend of the indicators passed the three-months critical point in either direction, business moved into a decided expansion or contraction.

The average trend did not quite reach the minus-three-months critical point last year. It has turned up this year, but is still well below the plus-three-months level. If upward trends of the past month or two continue, the average trend of the indicators will cross the plus-three-months point soon.

### Adding Up the Indicators

On the whole, the evidence presented by the key business indicators seems to point to an upturn in business activity. However, the National Bureau studies are careful to emphasize that the indicators tell you little about the *extent* or *duration* of any coming change in the business picture. Thus you need to weigh other factors in the situation in order to determine whether the current signs point to an extended period of good business.

AVERAGE OF THE TRENDS IS MOVING UP TOO




DATA: NATIONAL BUREAU OF ECONOMIC RESEARCH

CURRENT STATUS OF THE INDICATORS

| Leading | Latest Change | Recent Trend |
|---|---|---|
| New Orders for Durable Goods | Level | Up |
| Residential Building authorized | Up | Up |
| Nonresidential Building authorized | Up | Up |
| Industrial Stock Prices | Up | Up |
| 22 Commodity Prices | Level | Up |
| Average Hours Worked | Down | Up |
| New Incorporations | Up | Up |
| Liabilities of Business Failures | Down | Do |
| **Coincident** | | |
| Industrial Production | Up | Up |
| Freight Carloadings | Up | Down |
| Bank Debits | Down | Up |
| Nonfood Wholesale Prices | Level | Down |
| Nonagricultural Employment | Down | Up |
| Unemployment | Up | Level |

# CREDIT DEVELOPMENTS

The ready availability of credit at reasonable prices has helped check the decline in business. And the recent Federal Reserve action to lower bank reserve requirements points to a continued condition of "active ease" in money markets, for the next few months at least.

### Lower Business Borrowing

Bank loans to business are down almost $1½ billion from the end of last year. The decline was $700 million in the same period of 1953. Biggest declines were in metal working and in such seasonal lines as commodities, sales finance and food.

A number of factors explain the decline in business borrowing. Most important is the inventory adjustment. Many companies that were borrowing to build inventories last year are reducing stocks now and can repay loans. Moreover, business is generating a larger amount of internal funds—retained earnings are holding up well and depreciation charges are rising.

In addition, the operations of the corporate tax system will bolster corporate cash positions from now on. In the first half, corporations paid out $16.4 billion in taxes on last year's earnings.

From now to the end of 1954, they must pay out only $6.5 billion. And their tax bill in the first half of 1955 will be below this year's first half figure—because pre-tax earnings are lower and the excess profits tax no longer will be paid.

Bank loans to business usually rise in the second half of the year. Crops move to market and merchants stock up for the Christmas season. With inventory liquidation slowing down now, a renewal of the second-half seasonal advance in business borrowing seems probable.

### Consumer Credit

Consumer credit is a second major area where loans dropped this year. Total consumer borrowing reached a peak of $28.9 billion last December, then dropped to $27.2 billion in April, and has risen slightly since then.

Clearly, the policy of "active ease" in credit markets has not prevented a decline in business and consumer borrowing. But it has served to prevent the sort of forced liquidation that once characterized recessions. And it lays the groundwork for a rise in such borrowing as activity picks up.

In other areas, the availability of low-cost credit has had a stimulating effect. The net increase in mortgage loans is fully as big this year as last. It has been a major factor in keeping homebuilding at a high level.

State and municipal expenditures for public works are running 13% ahead of a year ago. The availability of funds has been an important factor here, too.

Treasury policy has also helped facilitate private borrowing. Treasury offerings have been confined to short and medium-term securities that will not compete with long-term private credit needs.

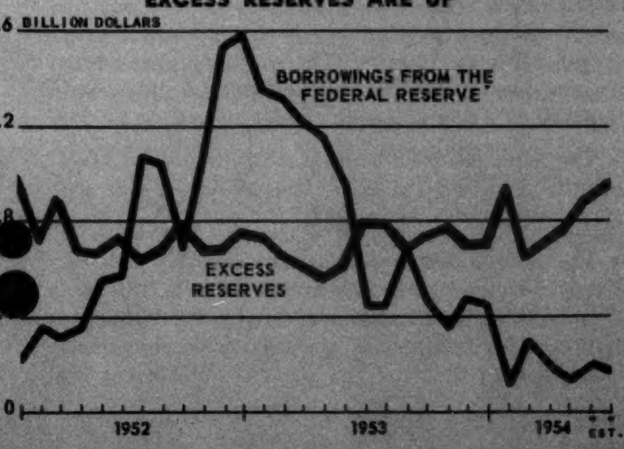
### Over-all Effects of Credit Trends

In over-all terms, the policies of the past year have provided the credit to ease the business readjustment. The national money supply added up to $197.2 billion at the end of April, almost $5 billion above a year earlier. Most of the rise was in time deposits.

The demand for credit is expected to rise in the second half. Treasury cash borrowing needs are officially estimated at $10 billion. And private borrowing could increase by several billion if bank loans follow the usual seasonal pattern, and if the rise in mortgages and corporate security flotations continues.

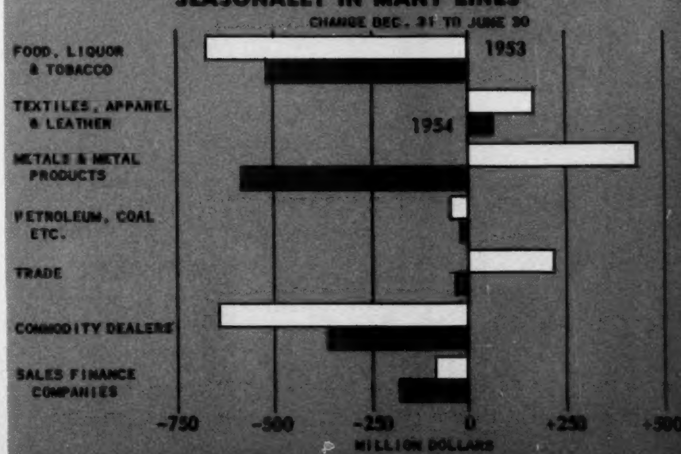
The recent reduction in bank reserve requirements falls short—by one fourth or more—of assuring that all these demands can be met without tightening credit. However, if it so desires, the Federal Reserve can provide funds by open market purchases of Government securities, as it has since mid-1953. Short of new and unforeseen developments, the indications are that the necessary steps will be taken to provide the credit needed to support the economy.

SHIFTS IN CREDIT POLICY—BORROWINGS ARE DOWN EXCESS RESERVES ARE UP




DATA: FEDERAL RESERVE BOARD

LOANS TO BUSINESS ARE DOWN MORE THAN SEASONALLY IN MANY LINES

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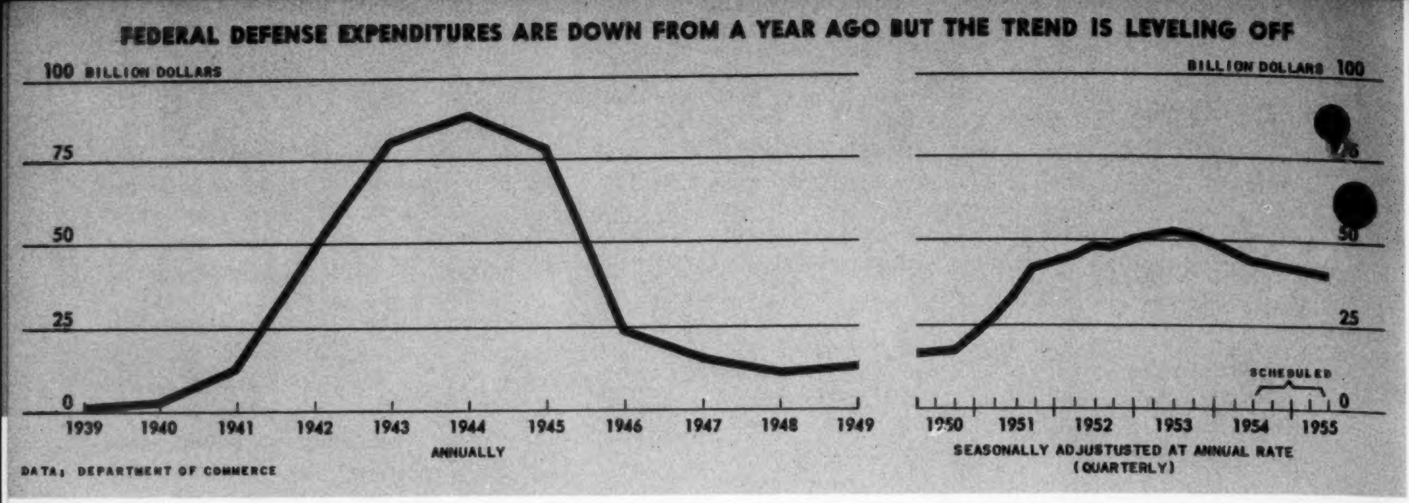


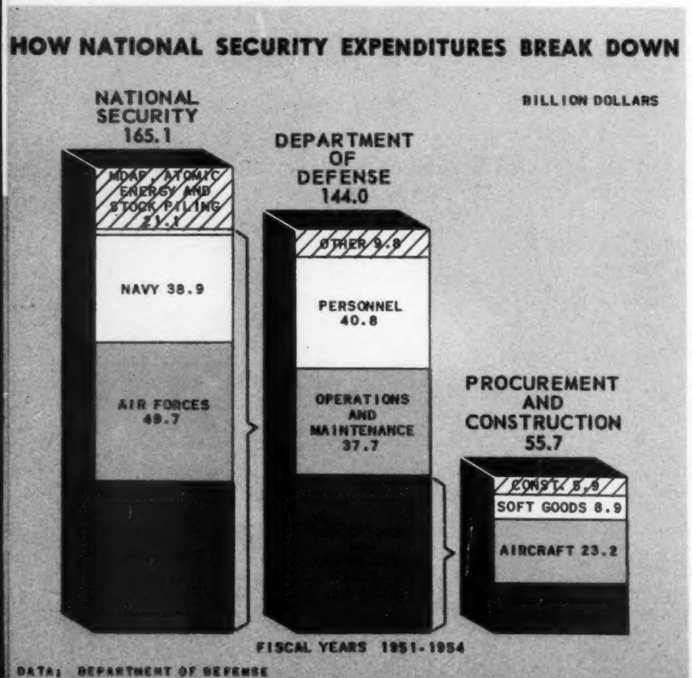

# DEFENSE PRODUCTION TRENDS

Defense production has been declining sharply for the past year. The decline began after the Eisenhower administration ended the war in Korea. Since then, we've been shifting to a maintenance basis.

Total national security expenditures reached their peak—at a $53.5 billion annual rate—in the second quarter of last year. In the second quarter of this year expenditures were down to a $44.5 billion rate.

The $9 billion drop in defense production was a major factor in the 10% decline in industrial production during the past year. It was almost as important as was the adjustment in business inventories.

Current schedules call for a much smaller drop in the coming year. The scheduled rate a year from now is estimated at $40 billion. Less than half the decline will be in production of military hard goods (planes, tanks, ships and the like). Much of the cut will reflect lower personnel costs.




### Indo-China Uncertainties

Current schedules do not reflect any basic change in strategy growing out of developments in Indo-China. The budget for fiscal 1955 includes over $1 billion for aid there. We now have large stocks of military equipment, so we could support a considerable Far-East defense effort without adding to our defense production.

In short, we're in far better shape on the defense production front than we were four years ago. When Korea was invaded, our national security expenditures stood at a $17 billion annual rate—and only $4 billion was going for military hard goods.

Since then, Congress has appropriated $238.8 billion for all national security programs. The current budget for fiscal 1955 (July 1, 1954 to June 30, 1955) calls for an additional $34.9 billion. The actual amount spent in the past four years adds up to $165 billion, with more than two-fifths of it expended for hard goods.

### Four Years' Defense Output

What have we accomplished in the past four years? We set out after the Korean invasion to build up our military forces, to establish a munitions industry that could turn out up-to-date weapons and form a nucleus for rapid expansion if need be, and to expand our industrial production base.

The build-up in our military strength in being was accomplished rather quickly. The number of men under arms rose from 1.3 million in June 1950 to 3.3 million in January 1952 and to a peak of 3.6 million in 1953.

- The Army has been built up to 21 divisions, or double the pre-Korean number. The Navy has over 400 active warships as against 200.

- The active inventory of planes used by the Air Force, Navy and Marine air arms runs to 33,000—one-third of them jets. In the next three years the inventory is scheduled to rise to 40,000 with more than half of them jets.

The build-up in military production has taken somewhat longer than the period necessary to reach peak strength in manpower. That was to be expected because of the long production period and great complexity of today's weapons. The electronic equipment on a B-47 bomber is said to cost more than a fully equipped B-29 Superfortress did in World War II.

However, we've produced about $60 billion of military hard goods for our own use and, in addition, shipped more than $10 billion to our Allies. Adjusted roughly for rising prices, the value of hard goods production since Korea is about half the value turned out during World War II.

### Production Shifts

Now that the defense production program is past its peak, and the build-up of stocks of most items is complete, the problem is to cut production to the level needed to maintain a flow of new and improved weapons.

In this process, scheduled cutbacks have been most severe in ground weapons. Expenditures for major Army items (tanks, ammunition, artillery, trucks and guns) are scheduled to drop from over $5 billion in fiscal 1954 to $2.6 billion in fiscal 1955.

These cutbacks are necessary to prevent a piling up of stocks of material that might become obsolete. In the absence of shooting wars, the problem in most Army items is to keep a nucleus of production facilities in operation and push development. The Army's budget for research and development is $375 million in fiscal 1955, only 10% below fiscal 1954.

Aircraft production is scheduled to remain at its current level of a bit more than $8 billion a year. However, the program is dynamic—new models are coming in to replace older models.

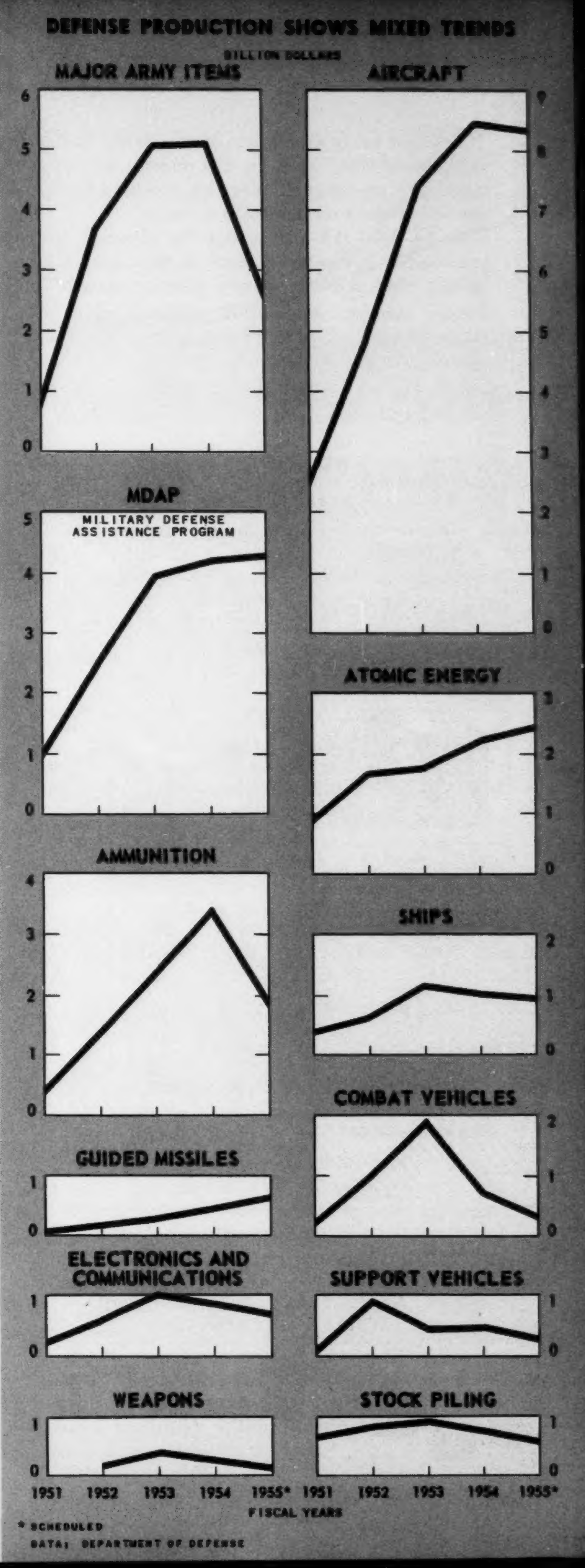
Today's aircraft are incredibly complex and difficult to produce. And the state of the arts is evolving rapidly. So continued high expenditures are needed to maintain our air strength.

The Navy ship program is virtually stable. It covers a relatively small amount of new construction plus a sizable program for rebuilding carriers and other vessels.

### Future Trends

One of the lessons of the past is that an on-again, off-again pattern of defense production is costly—both in dollars and in our ability to deal with the shifting international situation. The present defense program represents an attempt to get our military establishment and our military production on a sound, efficient basis for the long pull. And all indications are that we are in for a long pull—for no evidence whatsoever has emerged that points to a moderation of Soviet objectives.

The present program is not one that would be adequate to sustain an active war—of the Korean type or otherwise. Any new outbreaks would require a step-up in defense spending. But, because of the build-up of the past four years, we are in a better position to deal with new crises.



# FOREIGN TRADE

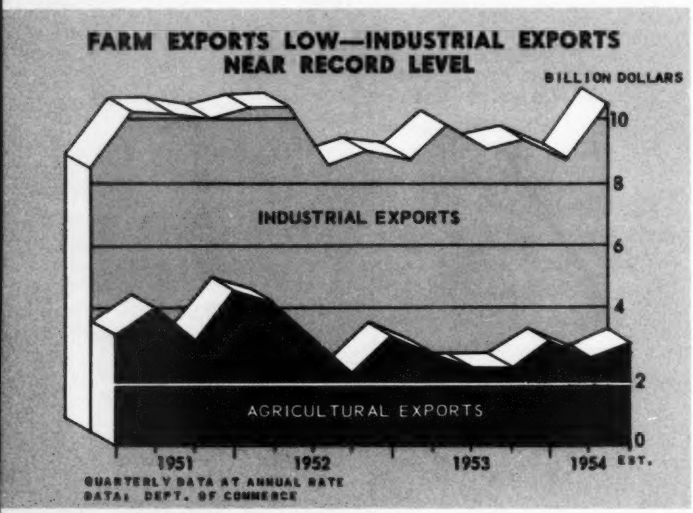
The past year's experience confounds the fear widely held abroad that "when the U.S. sneezes the rest of the world gets pneumonia". The U.S. recession has had no noticeable effect on the world economy.

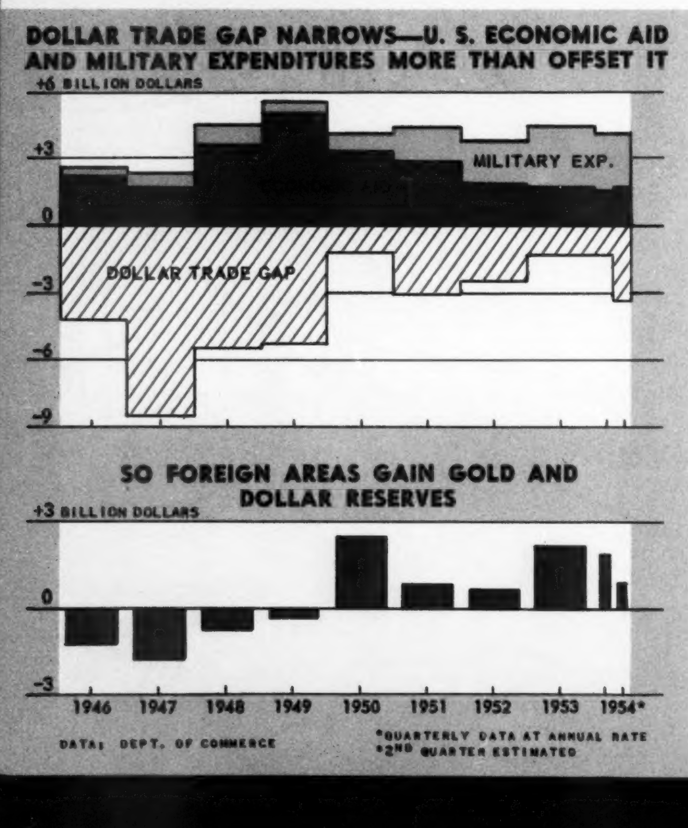
To be sure, U.S exports did dip about 5% below a year earlier in the first quarter of this year. But they made a quick recovery, despite growing competition for foreign markets. Preliminary estimates place second quarter exports at a $13.8 billion annual rate, the highest level since 1951 and early 1952.

U.S. imports dipped, too—about 10%. They also hit bottom in the first quarter and have picked up somewhat in the second.

Farm exports account for most of the decline in U.S. shipments from their peak in 1951. They fell from $4.0 billion in 1951 to only $2.8 billion last year.

In contrast, U.S. industrial exports are at a very high level indeed. Even if military shipments under the Mutual Security Program are subtracted, industrial exports ran at an estimated annual rate of $10.6 billion in the second quarter. That is a 23% recovery from the first quarter although perhaps half of the recovery reflects shipments held over as a result of the New York dock strike in March.




**Dollar Shortage Declining**

The strength of U.S. exports reflects both their strong competitive position and the declining dollar shortage abroad. The dollar trade gap—long the major obstacle to balanced world trade—is disappearing.

As late as 1948 and 1949 the world's deficit on non-military trade with the U.S. ran close to $5.5 billion per year. By 1953 the gap was reduced to $1.4 billion.

The dollar trade gap is down because of growing U.S. imports, not because of reduced exports. Imports rose from $6.6 billion in 1949 to $10.9 billion in 1953, while commercial exports held at just over $12 billion.

To offset the dollar gap after World War II the Truman Administration wisely provided foreign economic assistance. This aid reached a peak of $5 billion in 1949, then declined to $1.8 billion last year. Meanwhile, however, foreign purchases by the U.S. military services were expanding.

Thus, economic aid plus our foreign military expenditures have more than counter-balanced the declining dollar trade gap. As a result, from 1950 onward the rest of the world has enjoyed a surplus on all payments with the U.S. This surplus reached a peak in 1950, when the Korean War brought on a temporary U.S. import spree. But by 1953 the world was strong enough economically to earn almost as large a surplus without the help of a war-induced commodity boom.

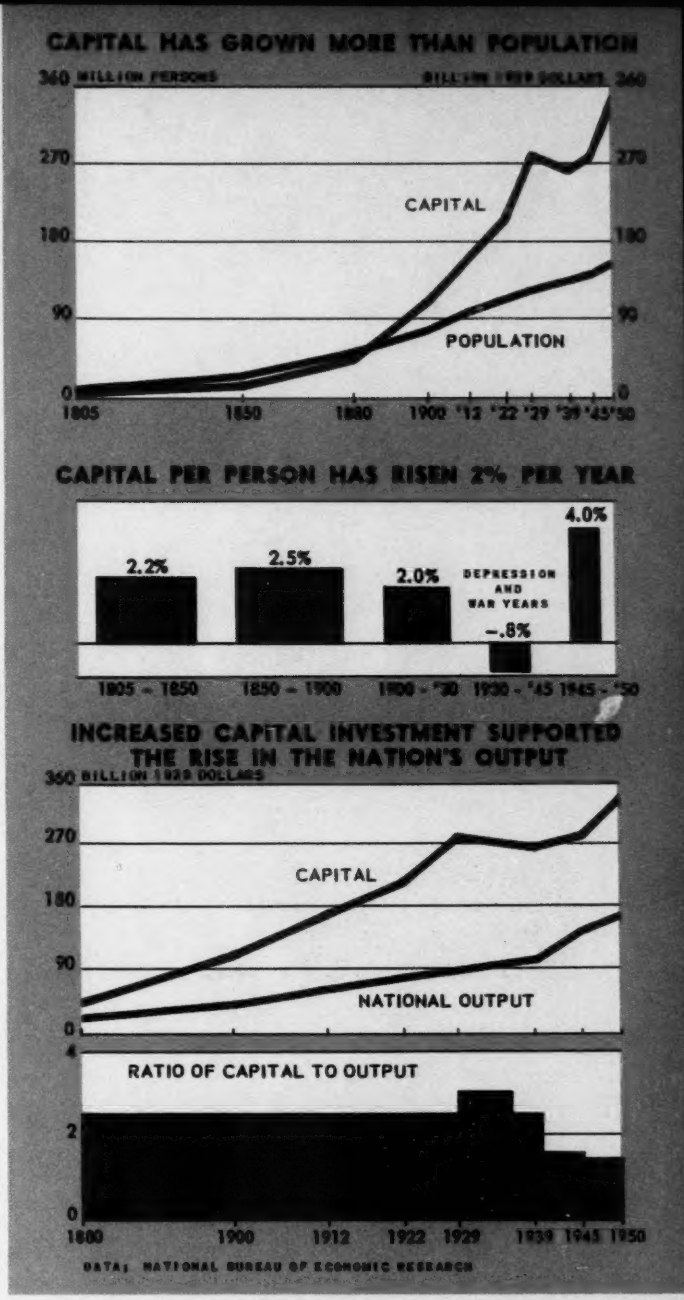
Foreign countries used their surplus to add substantially to their gold and dollar reserves. These monetary gains have made possible important steps toward freer international trade and payments:

- The United Kingdom and Western Germany, for instance, have been able to cut down restrictions on foreign exchange transfers, moving closer to convertibility of their currencies.

- A number of European countries recently eased discrimination against dollar imports.

The government is on the right track in urging increased foreign trade. But we must encourage foreign investment more vigorously if it is to be a major element in the long range balance of payments situation.

# ECONOMIC GROWTH




The long-term growth record of the U.S. economy has been widely heralded. Production per person has risen at an average rate of 1.9% per year for a century and probably for a century and a half. Thus, living standards have doubled about every 35 years. That's a long-term growth unparalleled in history.

Until recently little attention was devoted to searching out the reasons for this remarkable performance. However, The National Bureau of Economic Research has just published a series of studies that shed new light on the factors underlying our economic growth. They are summarized in the Bureau's 34th *Annual Report.*

**Growth in Capital**

A nation's output depends on what its people put into production—on the hours, the energy, the skill and the enterprise of its people and on the capital and techniques they have to work with. But the Bureau's studies underline this point:

> "Those who stress the role of savings in our economic growth are right to do so, for they point to the dominant factor in the increase of our material resources".

The nation's capital* has multiplied several times more rapidly than has population. New estimates prepared by the Bureau show that capital per person is over four times the volume in the 1870's.

The average annual growth in capital per person works out to 2% per year. That this is almost the same as the long-term average growth in production per person is more than a coincidence. It is by putting into use more capital that we have been able to multiply the efficiency of our production and thus raise living standards. That's shown by the fact that the ratio of capital to output was constant for the period 1897-1929 and probably for most of the 1800's. For the nation as a whole, it took $2.50 of capital to produce $1.00 of output during this period.

**Uneven Growth**

The upward march of production per person and capital per person has not been steady and smooth. Besides swings associated with business cycles, there have been longer term variations in the growth rate.

However, there is no clear evidence that the forces pushing our national level of living upward have lost their potency. The 1930's were, of course, a period of no growth. But the postwar period shows a clear resumption of the growth trend.

Since 1945 the increase in capital per person has averaged fully 4% per year, or double the long-term average. Part of the recent high rate may be due to catching up from the low level of capital output during the 1930's. It may be 1960 before the ratio of capital to national output gets back to the 2½ times figure that persisted through most of our economic history. But it is also possible that we're moving into an era where larger capital investment per person will be required to sustain the growth in living standards.

Be that as it may, the over-all conclusion is that our growth will be maintained, given capital accumulation and proper incentives. In short, the theory that ours is a "mature economy" without substantial prospects for growth is not borne out by the facts.

* Capital is defined as our stock of buildings, production equipment, inventories and net foreign assets, net of depreciation. The National Bureau has measured it in constant dollars of 1929 purchasing power. Consumer's equipment, military goods, land and subsoil assets are excluded.